Financing agribusiness and value chain development in the Pacific

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CTA Policy Brief

The agriculture sector, a major source of food and livelihood for up to 80% of the population in Pacific Island Countries, is under-funded. Lending to the sector is less than 2%, despite its contribution to gross domestic product (GDP). Transforming the Pacific agri-food system to address the major socio-economic challenges – malnutrition, high dependence on imported foods, unemployment and climate change – will require targeted public and private investments. Financial institutions and governments must work together to offer innovative financial instruments that enhance access to banking services, especially in the rural areas. Inclusivity is a win-win strategy.

Policy action needed

- **Provide adequate public financing** for implementing agricultural policies and priority programmes
- **Design a business and financial ecosystem for agro-based micro-, small- and medium-sized enterprises (MSMEs) to flourish** – foster strategic partnerships and simplify processes
- **Promote blended financing mechanisms** to mobilise public and private capital and apply a value chain lens to agricultural financing
- **Make financial services accessible and affordable, especially for remote rural communities** – invest in financial technology and mobile banking services
- **Build capacity of producer organisations and MSMEs** – financial literacy is critical.

What is the problem?

The majority of farmers, fishers and agro-based micro-, small- and medium-sized enterprises (MSMEs) in Pacific Island Countries (PICs) face challenges in accessing finance to sustain their business. Much of the available funding tends to be informal and short-term, partially covering their needs and usually at a high cost. In Fiji, Kiribati, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga and Vanuatu, the agricultural sector receives between 1% and 2% of total lending from commercial banks, development financial institutions (DFIs) and asset leasing companies. Agriculture lending from DFIs tends to be higher; between 1% and 21%. For example, between 2008-2017, the Fiji Development Bank (FDB) increased lending from 10 to 18%.

Regulations or laws governing the provision of agricultural finance generally reside in the enabling Acts in the DFIs. Of the seven countries, only the FDB, Development Bank of Samoa and Vanuatu Agriculture Development Bank specifically refer to agriculture financing in their respective Acts; all others mention enterprises engaged in economic or socio-economic development that indirectly include agriculture. Several licensed commercial banks, foreign (8) and national (4), also provide financing to the agricultural sector. These include ANZ Bank which is present in six of the seven PICs; Bank of South Pacific (BSP) in five and Bred Bank in three.

Financial institutions face several challenges in offering products and services in the PICs, namely:

- **High transaction costs**: for both service providers and clients in reaching remote and dispersed rural populations

August 2019

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- **Systemic risks**: production uncertainties linked to natural hazards, price volatility and market failures, as well as weak ability of producers to provide collateral or historical production and sales data based on proper record keeping
- **Limited capability to tailor products to the market**: inability to design financial services and/or products to target potential clients because of limited knowledge on production processes and the diverse needs of small producers and MSMEs
- **Highly politicised** and sensitive nature of agriculture.

Some banks in the seven PICs are successfully implementing programmes that expand their reach as part of a win-win strategy that benefits rural communities and grows their customer base. For example, the National Bank of Vanuatu launched a financial literacy programme in 2017, trained 50,000 participants, opened 40,000 new accounts and diversified its product offerings to include same day approval micro loans and mentoring and advisory services.

What can be done to solve this problem?

All seven countries have up-to-date ambitious and forward-looking agricultural development policies but only a few - Samoa and Tonga - have determined the cost of implementing the development plans and identified sources of the necessary funding. However, securing financing for upgrading and/or modernising infrastructure from governments, development partners, donors and the private sector is difficult. Transitioning to high performing sustainable agri-food systems to improve food security, incomes and nutrition outcomes in the PICs will require changes in government and banking policies and regulations, investments in infrastructure and capacity building; specifically, financial literacy and mentorship support and increasing access to affordable financial services, especially in rural areas.

Develop coherent agricultural, economy, finance, business and trade policies

Governments should ensure that policies or instruments affecting the agricultural sector are harmonised with other allied policies – economic development, banking, finance and insurance, public procurement; health and nutrition; transport, communication and logistics including ICT connectivity; environment and climate change.

Apply a value-chain lens to agricultural financing

Looking at the whole value chain radically alters the perception of risk and potential returns. It opens up possibilities to extend credit to those who would not normally meet traditional lending requirements. This requires the financier to identify and analyse the elements in the value chain and develop financial products and services to meet the needs of participants at various points along the chain. It also allows financial institutions to use contracts between value-chain participants as security for loans, rather than more traditional forms of collateral. This approach will necessitate building the capacity of commercial banks and DFIs in value-chain analysis and introducing changes to banking rules and regulations to accommodate new standards for collateral and security.

Cost proposed actions for implementing agricultural policies and plans

Governments should develop detailed cost projections for implementing policies, plans and priority actions and modify them as needed when preparing the annual national budgets. The cost estimates are also useful for mobilising complementary funding from banks, donors, development partners, and other stakeholders and monitoring and evaluating achievements. Governments should give priority to actions that contribute to improving agricultural performance, including the development of infrastructure, such as roads, communications, quality and food safety certified postharvest handling and shipping facilities. For example, Tonga's public Wharf Exporting Processing Facility is operated by the Tonga National Food Authority. It is accessible to small-scale farmers/first-time exporters at a nominal fee to package their goods for export. The facility was established by the Ministry of Agriculture and Food, Forests and Fisheries in 2016. Inexperienced exporters also receive training to help them reach the international standards required by overseas markets.

Revive and revamp the development financing institutions

Agriculture should be a clear priority for accessing loans from the DFIs. The Government of Fiji, for example, has directed the FDB to increase its participation in the agriculture sector, aiming for 50% of the Bank's portfolio. This might be a useful model for the region.

Multilateral financial institutions such as the World Bank, the Asian Development Bank and the European Investment Bank can be tapped for providing technical assistance, training, project analysis and loan administration.

Additional funds could be raised by mandating that all banks and insurance companies should invest, say, 5% of their statutory reserve deposits in the agriculture sector, either directly or through a DFI. Another possibility would be to encourage commercial banks to lend at least 50% of savings originating from agriculture and agribusiness back to the sector(s).

Strengthen producer organisations and encourage development of groups or clusters of value-chain actors

Strong well organised farmers' organisations and cooperatives or similar associations are needed to help aggregate operations to achieve economies of scale for accessing financing, inputs and other services (including business and extension services). This also helps in responding to the demands of the market for consistent quantities and quality, and in giving them a stronger voice in shaping policy as well as negotiating prices in the market place. They would also provide an entry point for programmes to make small-scale farmers, fishers and MSMEs more 'bank-ready' such as training in record-keeping and increasing their understanding of business and banking requirements.

Public-private financing

Blended financing – the strategic use of development finance for the mobilisation of additional finance – will be crucial to transforming the agri-food system in the Pacific Island States. This implies using government and donor funding to leverage private sector financing for the sector.

De-risk agricultural investment

With climate change, the risk of catastrophic losses to extreme weather events has grown markedly in recent years. One consequence of this is that local lenders and insurers are often unwilling to offer loans or insurance to farmers or other members of agricultural value chains because their losses would overwhelm them in the event of a catastrophic weather event. Addressing this requires approaches such as the government underwriting of agricultural insurance and loans.

Support development of financial technology

Financial technology such as mobile banking, e-payment systems and digital ledgers is essential to reach widely dispersed rural populations. Supporting the evolution will require development of policies and mobile phone infrastructure and collaboration between governments, financial institutions and telecommunications and information technology (IT) service providers. For example, the Development Bank of Samoa has partnered with Sky Eye Samoa, a local IT company to digitally map all its client locations. The Pacific Financial Inclusion Programme has developed the PacFarmer App which farmers can use to track their income and expenses and the electronic records can be used as part of their loan applications.

Conclusion

Improving the performance of the agri-food system in the Pacific Island Countries requires a transition to a more organised and efficient way of producing, processing, marketing and trade; from farm to plate, and a wider view of the opportunities for diversifying diets and incomes. This suggests the need for mobilising significant financial investments, including for the development of infrastructure such as transport networks and ICTs, markets and services. Currently, agriculture receives limited funding from government sources and only a fraction of total lending from banks and other financial institutions. The cost of doing business is very high, especially for agro-based MSMEs.

Addressing this situation comprehensively will require changes in the policy environment for agriculture, MSME development and financial sector, and a clear emphasis on the provision of innovative inclusive financial services by DFIs and commercial lenders. It also calls for the application of a value-chain approach to finance, as well as the development of public-private partnerships and innovations in financial technologies to bring currently un-banked farmers and agribusinesses into the traditional financial sector. Farmers' organisations – currently underdeveloped in the Pacific Island Countries but growing in strength – will have a key role to play in raising the financial literacy of members and agribusinesses and in increasing the uptake of new technology and services to boost agricultural-led sustainable economic transformation.

About the project

The project "Leveraging the Development of Local Food Crops and Fisheries Value Chains for Improved Nutrition and Sustainable Food Systems in the Pacific Islands with a focus on Fiji, Kiribati, Marshall Islands, Samoa, Solomon Islands, Tonga, and Vanuatu" is co-funded by the International Fund for Agricultural Development (IFAD) and the Technical Centre for Agricultural and Rural Cooperation (CTA) and is implemented in partnership with the Pacific Islands Private Sector Organisation (PIPSO). The goal is to strengthen the capacity of the Pacific Island governments, farmer and private sector organisations, and sub-regional institutions to develop strategies and programmes – as well as mobilise financing – that can increase poor rural people's access to nutritious and healthy food. CTA has overall responsibility for the implementation of the project.

About the project partners

IFAD

The International Fund for Agricultural Development (IFAD), a specialised agency of the United Nations, was established as an international financial institution in 1977 as one of the major outcomes of the 1974 World Food Conference.

IFAD
Investing in rural people

PIPSO

The Pacific Islands Private Sector Organization (PIPSO) is the premier private sector representative body in the Pacific Islands region. It was set up through the mandate of the Forum Economic Ministers in 2005, and legally established in 2007, to be the representative body of the Pacific region's private sector.

PIPSO
Pacific Islands Private Sector Organisation

Further reading

Bovoro, T. 2018. *Documenting legislation and access to finance and agri-value chain risk management.* Final Report. Technical Centre for Agricultural and Rural Cooperation (CTA), Wageningen, The Netherlands.

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About the series

CTA Policy Briefs provide a concise summary of a particular issue of relevance to the Centre's activities, the policy options to deal with it, and some recommendations on the best option. They are aimed at policy-makers and their technical advisors, academics and educators working in the policy field and others who are interested in formulating or influencing policy.

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